

**TENNESSEE DEPARTMENT OF REVENUE  
LETTER RULING 03-12**

**WARNING**

**Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.**

**SUBJECT**

Application of the Tennessee sales and use tax to a company engaged in the business of providing [INDUSTRY] information systems, software, and services to large, [INDUSTRY], principally in the United States.

**SCOPE**

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the taxpayer. The rulings herein are binding upon the Department and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time.

Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

**FACTS**

[TAXPAYER] is engaged in the business of providing [INDUSTRY] information systems, software, and services to large, [INDUSTRY], principally in the United States, including Tennessee. According to Taxpayer, this software is “canned” software. Taxpayer collects sales tax on all software delivered via physical media or electronically into Tennessee. Taxpayer has further indicated that all shipments of software originate outside of Tennessee and that it has nexus with Tennessee. Taxpayer’s revenues are derived from the licensing of software, hardware sales, the provision of maintenance services, services related to systems sales, and from the provision of [UNRELATED SERVICES].

Taxpayer is implementing a new service, referred to as “timeshare,” whereby it will act as an application service provider (“ASP”). For a monthly fee, clients will be allowed to access Taxpayer’s software remotely via the Internet. The software will be stored on Taxpayer’s computers. Generally, the computers will be located outside of Tennessee, but in some instances may be in Tennessee.

Clients will be able to use different software modules depending on what access rights are purchased. Taxpayer’s software applications include:

1. Billing and Accounts Receivable – Manage financial data and maximize revenue collection.
2. [ACCOUNTING] – Monitor [BILLING], collections and [OTHER] activities.
3. Enterprise Wide Scheduling – Automates routine tasks, ensures [ACCESS] to services, and provides a consistent view of [INFORMATION].

Taxpayer does not supply the Internet connection needed to access the service, and does not fabricate or host websites for clients. Clients gain no rights to the software. The software always remains on Taxpayer’s servers. The software is never installed on, or transferred to, the clients’ computers.

As part of its new service, Taxpayer provides training to the customers in the use of the software. The training is conducted both in Tennessee and at locations outside of Tennessee. The training fees are separately stated in customer contracts and on customer invoices.

## **QUESTIONS**

1. Is the monthly fee paid by clients to access software through the Internet subject to sales and use tax?

2. Does the answer to Question One vary depending upon whether the hardware and software are located outside Tennessee or inside Tennessee but not at the customer location?
3. If the monthly fee is taxable, does the \$1,600.00 single article limitation apply to the monthly fee? How would the cap be applied to the monthly fee?

### **RULING**

- 1 - 3. Regardless of whether Taxpayer's hardware and software are located in Tennessee, the monthly fee charged in exchange for access to the software is not subject to the sales and use tax.

### **ANALYSIS**

1 - 3. The sale of customized or packaged computer software, as well as the modification of existing software, is subject to sales and use tax. TENN. CODE ANN. § 67-6-102(a)(27)(B); University Computing Company v. Olsen, 677 S.W.2d 445 (Tenn. 1984); Creasy Systems Consultants, Inc. v. Olsen, 716 S.W.2d 35 (Tenn. 1986). The term "sale" is defined to include:

[the] *transfer* of customized or packaged computer software, which is defined to mean, information and directions loaded into a computer which dictates different functions to be performed by the computer whether contained on tapes, discs, cards, or other device or material.

TENN. CODE ANN. § 67-6-102(a)(27)(B) (emphasis supplied). However, the fabrication of software by a person for such person's own use or consumption shall not be considered a taxable 'use'... *Id.*

Further, certain services are subject to sales and use tax. TENN. CODE ANN. §§ 67-6-201, 67-6-205. Taxable services include, but are not limited to, repair work, telecommunication services, installation and certain warranty or services contracts. Also, services provided as part of the sale of tangible personal property are taxable as part of the sales price of such property. TENN. CODE ANN. § 67-6-102(a)(28).

Here, Taxpayer proposes a new service whereby clients will be allowed to access Taxpayer's software remotely via the Internet. The software always remains on Taxpayer's servers. The software is never installed on, or transferred to, the clients' computers. Because title and possession of the software always reside with Taxpayer, there is no transfer for purposes of TENN. CODE ANN. § 67-6-102(25)(B). Moreover, Taxpayer's service is not included in the list of specifically taxable services and is not a part of the sale of tangible personal

property under the definition of sales price. Because there is no transfer of title or possession, the monthly fee to access the software through the Internet is not a taxable sale. This is true regardless of whether Taxpayer's hardware and software are located in Tennessee.

Because there is no sale of the software, Taxpayer is not required to collect and remit Tennessee sales tax. Moreover, the single article limitation is inapplicable to the facts as presented.

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APPROVED: Loren L. Chumley  
Commissioner

DATE: 12/4/03